FILED
JUL 6 1951
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States.

OCTOBER TERM, 1951.

No. 98.

HAROLD S. BAIRD,
Petitioner,

against

GUARANTY TRUST COMPANY OF NEW YORK, as Trustee under the First Consolidated Mortgage Deed of The Rio Grande Western Railway Company, dated April 1, 1899, JULIUS KLORFEIN, THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK, as Trustee under the Refunding and Improvement Mortgage of The Denver and Rio Grande Western Railroad Company, dated February 1, 1924, CITY BANK FARMERS TRUST COMPANY, as Trustee under The Denver and Rio Grande Western Railroad Company's General Mortgage, dated February 1, 1924, WESTERN PACIFIC RAILROAD CORPORATION, GUY A. THOMPSON, as Trustee of the properties of Missouri Pacific Railroad Company, JAMES S. ALEXANDER, as Trustee, and his successors under an Agreement dated December 20, 1924, between him, The Western Pacific Railroad Corporation, The Denver and Rio Grande Western Railroad Company and Missouri Pacific Railroad Company, and THE DENVER AND RIO GRANDE WESTERN RAILROAD COMPANY,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF NEW YORK.

BRIEF FOR RESPONDENT THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK, AS TRUSTEE UNDER THE REFUNDING AND IMPROVEMENT MORTGAGE OF THE DENVER AND RIO GRANDE WESTERN RAILROAD COMPANY DATED FEBRUARY 1, 1924, IN OPPOSITION.

ORVILLE W. WOOD,
Attorney for Respondent The Chase National Bank of the City of New York, as Trustee under the Refunding and Improvement Mortgage of The Denver and Rio Grande Western Railroad Company dated February 1, 1924.

July 3, 1951.

INDEX.

	PAGE
OPINION BELOW	1
JURISDICTION	2
QUESTION PRESENTED	2
STATEMENT	2
ARGUMENT	3
POINT I. The decision below is in accord with the decisions of this Court	3
POINT II. The decision below presents no federal question	6
POINT III. The decision below presents no question of sufficient public importance to warrant review by this Court	7
CONCLUSION	8

TABLE OF AUTHORITIES CITED.

Cases.

Case *v.* Los Angeles Lumber Co., 308 U. S. 106 (1939)	6
Consolidated Rock Products Co. *v.* Du Bois, 312 U. S. 510 (1941)	6
Continental Gin Co. *v.* Arnold, 52 Okla. 569, 153 Pac. 160 (1915)	5
Group of Investors *v.* Milwaukee R. Co., 318 U. S. 523 (1943)	6
Insurance Group *v.* D. & R. G. W. R. Co., 329 U. S. 607 (1947)	3, 5
R. F. C. *v.* Denver & R. G. W. R. Co., 328 U. S. 495 (1946)	3, 4, 6

PAGE

Statutes.

Bankruptcy Act:
Chapter X (11 U. S. C., c. 10) ---------- 8
Section 77 (11 U. S. C. § 205) ---------- 2, 8
Section 77B (48 Stat. 911, 912 (1934), as amended) 8

IN THE

Supreme Court of the United States,

OCTOBER TERM, 1951.

No. 98.

HAROLD S. BAIRD,
Petitioner,

against

GUARANTY TRUST COMPANY OF NEW YORK, as Trustee under the First Consolidated Mortgage Deed of The Rio Grande Western Railway Company, dated April 1, 1899, JULIUS KLORFEIN, THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK, as Trustee under the Refunding and Improvement Mortgage of The Denver and Rio Grande Western Railroad Company, dated February 1, 1924, CITY BANK FARMERS TRUST COMPANY, as Trustee under The Denver and Rio Grande Western Railroad Company's General Mortgage, dated February 1, 1924, WESTERN PACIFIC RAILROAD CORPORATION, GUY A. THOMPSON, as Trustee of the properties of Missouri Pacific Railroad Company, JAMES S. ALEXANDER, as Trustee, and his successors under an Agreement dated December 20, 1924, between him, The Western Pacific Railroad Corporation, The Denver and Rio Grande Western Railroad Company and Missouri Pacific Railroad Company, and THE DENVER AND RIO GRANDE WESTERN RAILROAD COMPANY,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF NEW YORK.

BRIEF FOR RESPONDENT THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK, AS TRUSTEE UNDER THE REFUNDING AND IMPROVEMENT MORTGAGE OF THE DENVER AND RIO GRANDE WESTERN RAILROAD COMPANY DATED FEBRUARY 1, 1924, IN OPPOSITION.

Opinion Below.

The only opinion delivered in the courts below is the interlocutory decision of the New York Supreme Court

(R. 118), which is reported at 194 Misc. 628, 86 N. Y. S. 2d 505. The unanimous affirmance without opinion by the Appellate Division (R. 260) is reported at 277 App. Div. 767, 97 N. Y. S. 2d 542. The unanimous affirmance without opinion by the Court of Appeals (R. 270) is reported at 302 N. Y. 658, 98 N. E. 2d 474.

Jurisdiction.

The judgment of the Court of Appeals now sought to be reviewed was entered on March 9, 1951. The jurisdiction of this Court is invoked by the petitioner under 28 U. S. C. §§ 1257(3) and 2101(c).

Question Presented.

Whether "full payment" for the purpose of satisfying the so-called "full or absolute priority rule" with respect to an allocation of new securities under a Section 77 plan of reorganization is synonymous with "full payment" for the purpose of discharging accommodation collateral which was not the property of the debtor in the Section 77 proceeding.

Statement.

The relevant facts are sufficiently stated in the petition; we shall not restate them here.

ARGUMENT.

POINT I.

The decision below is in accord with the decisions of this Court.

The petitioner seeks to show (Pet., pp. 9-11) that the decision below is in conflict with decisions of this Court dealing with the priority rule.

We believe there is no such conflict.

The petitioner's argument is in essence that the question involved in this case was adjudicated by this Court in the Denver reorganization. This argument erroneously assumes that the question decided by the courts below was identical with the question decided by this Court in the Denver reorganization.

In the Denver reorganization, this Court decided that, from the viewpoint of the plan in the reorganization, the compensation in the form of new securities to the holders of senior bonds "was adequate in the light of the full priority rule."[1] The question decided by the courts below was whether, from the viewpoint of discharging their liens on the Utah Fuel Company stock, the holders of these bonds had received full payment. This question was not before this Court; since the Utah Fuel Company stock was accommodation collateral not a part of the property of the debtor, this Court had no jurisdiction to decide the question. This Court expressly stated that it "should not be taken as deciding this question"; this question, the Court said, must be decided in "an independent suit in which there is jurisdiction over the proper parties".[2] This Court

---

[1] R. F. C. v. Denver & R. G. W. R. Co., 328 U. S. 495, 517 (1946).

"* * * We held the priority rule was satisfied by this type of allocation. This was explained by our decision on the last review. * * *" (Insurance Group v. D. & R. G. W. R. Co., 329 U. S. 607, 617 (1947))

[2] 328 U. S. at 531, n. 33.

also stated that the trustee for the junior bonds would have an opportunity in this independent suit to show that the holders of senior bonds had received full payment "if such be the fact."[3]

The petitioner's argument rests, we believe, upon a misconception of the priority rule.

The misconception is that "full payment" for the purpose of satisfying the priority rule with respect to an allocation of new securities is synonymous with "full payment" for the purpose of discharging accommodation collateral.

The argument, we believe, ignores the distinction between two different legal concepts. One concept is that "full payment" for the purpose of discharging accommodation collateral means payment in cash, or in something having a presently realizable cash value, equal to the full amount of the indebtedness. The other concept is that "full payment" for the purpose of satisfying the priority rule with respect to an allocation of new securities means the substitution of a new bundle of rights which affords the creditor substantially as favorable an opportunity for ultimate payment as did his old bundle of rights.

The distinction becomes apparent if we look at the difference in the factual situations to which these legal concepts relate.

First, let us consider the concept of "full payment" for the purpose of discharging accommodation collateral.

The factual situation here is the present payment of a money obligation. To compel a pledgee of accommodation collateral to surrender his security, it is not enough to offer him a right to get paid at some future time; he is entitled to insist upon present payment, in the ordinary sense in which the word "payment" is generally understood. "Payment", in this sense, means that the creditor has got his money back, i. e., has received cash, or at least some-

[3] *Id.* at 530.

thing having a presently realizable cash value, equal to the full amount of the indebtedness.[4]

Next, let us consider the concept of "full payment" for the purpose of satisfying the priority rule with respect to an allocation of new securities.

Here we have a very different factual situation. When a creditor receives new securities under a plan of reorganization, there is no present payment of the indebtedness; in fact, there is no payment at all in the ordinary sense. What has happened is merely that the creditor's claim against the debtor has been replaced by a new claim against the reorganized debtor; the creditor has received a new bundle of rights in exchange for his old bundle of rights. His new bundle of rights may enable him ultimately to get paid, but there is no certainty that he actually will get paid. A creditor who receives new securities is not getting his money back; he is keeping it invested in the enterprise. He is continuing as a partner in a business venture, with the hope that he may ultimately get his money back, but with the attendant risk that the venture may prove unprofitable.

In this factual situation, the priority rule is not concerned with the question of actual payment, in the sense of a creditor getting his money back, but with the question whether the new bundle of rights affords the creditor substantially as favorable an opportunity for ultimate payment as he had before. Consequently, the priority rule does not require that the new securities have a presently realizable cash value equal to the full amount of the indebtedness; it merely requires that the new securities be the "equitable equivalent" of the old securities;[5] and "full

---

[4] " 'Payment' is generally understood as a discharge of the debt or obligation by a compliance with the terms of the obligation, and, if the obligation calls for a money discharge, then there cannot be payment except by paying the full amount called for in money, or the representative of money. * * *" (Continental Gin Co. v. Arnold, 52 Okla. 569, 574, 153 Pac. 160, 162 (1915))

[5] "The Commission made no finding that the cash value of the securities allocated to the senior creditors paid them in full. * * *

payment", for the purpose of satisfying the priority rule, does not mean that the creditor has got his money back; it means merely that the new securities afford him substantially as favorable an opportunity for ultimate payment as did his old securities.

In this factual situation, to say that the creditor has received "payment" is to use the word "payment" in a special sense—not in the sense in which the word is generally understood.

The courts below, we believe, correctly understood the meaning and effect of the priority rule and the decisions of this Court in the Denver reorganization; they simply recognized that, in a different factual situation, the rights of the parties were governed by a different legal concept.

POINT II.

The decision below presents no federal question.

The question decided by the courts below was whether, from the viewpoint of discharging their liens on the Utah Fuel Company stock, the holders of senior bonds had received full payment.

In deciding this question, the courts below recognized that the rights of the parties were governed, not by the pri-

---

We held the priority rule was satisfied by this type of allocation. * * *" (Insurance Group v. D. & R. G. W. R. Co., 329 U. S. 607, 617 (1947))

"* * * It is sufficient that each security holder in the order of his priority receives from that which is available for the satisfaction of his claim the equitable equivalent of the rights surrendered. That requires a comparison of the new securities allotted to him with the old securities which he exchanges to determine whether the new are the equitable equivalent of the old. * * *" (Group of Investors v. Milwaukee R. Co., 318 U. S. 523, 565-566 (1943))

See also: R. F. C. v. Denver & R. G. W. R. Co., 328 U. S. 495, 517-518 (1946); Consolidated Rock Products Co. v. Du Bois, 312 U. S. 510, 528, 529 (1941); Case v. Los Angeles Lumber Co., 308 U. S. 106, 117 (1939).

ority rule, but by the ordinary principle of the law of pledges that a pledgee of accommodation collateral cannot be compelled to surrender his security unless he has received cash, or something having a presently realizable cash value, equal to the full amount of the indebtedness. Applying this principle of the law of pledges to the factual situation before them, the courts below found that the holders of senior bonds had not received full payment.

The decision below thus presents no federal question; it presents merely a question of the New York law of pledges.

POINT III.

The decision below presents no question of sufficient public importance to warrant review by this Court.

The petitioner asserts (Pet., p. 12) that the question presented by the decision below is of "far-reaching public importance", involving the "meaning, the effect and, indeed, the integrity" of the priority rule.

For the reasons set forth under Point I of this brief, we believe the courts below correctly understood the meaning and effect of the priority rule. They simply recognized that, in the different factual situation before them, the rights of the parties were governed, not by the priority rule, but by the ordinary principle of the law of pledges that a pledgee of accommodation collateral cannot be compelled to surrender his security unless he has received cash, or something having a presently realizable cash value, equal to the full amount of the indebtedness. Thus no question is presented as to the "integrity" of the priority rule but merely a question of the New York law of pledges.

The petitioner also asserts (Pet., pp. 11-12) that the question presented by the decision below "will recur with increasing frequency".

We are now approaching the close of the second decade of reorganizations under the federal bankruptcy statutes. Notwithstanding the vast number of reorganization proceedings instituted during this period under Section 77, Section 77B, and Chapter X, the peculiar factual situation involved in this case has apparently never before been presented to any court. This would seem to indicate that this case presents an isolated example of a question not likely to arise again.

CONCLUSION.

The decision below is correct. It is in accord with the decisions of this Court. It presents no federal question and presents no question of sufficient public importance to warrant review by this Court. The petition should be denied.

Respectfully submitted,

ORVILLE W. WOOD,
Attorney for Respondent The Chase National Bank of the City of New York, as Trustee under the Refunding and Improvement Mortgage of The Denver and Rio Grande Western Railroad Company dated February 1, 1924.

July 3, 1951.

Q

JUL 24 1951

CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1951

No. 99

HAROLD S. RAPER,

Petitioner,

against

GUARANTY TRUST COMPANY OF NEW YORK, as Trustee under the First Consolidated Mortgage Deed of The Rio Grande Western Railway Company, dated April 1, 1899, JULIUS KLEIN-ERT, THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK, as Trustee under the Refunding and Improvement Mortgage of The Denver and Rio Grande Western Railroad Company, dated February 1, 1924, CITY BANK FARMERS TRUST COMPANY, as Trustee under The Denver and Rio Grande Western Railroad Company's General Mortgage, dated February 1, 1926, WESTERN PACIFIC RAILROAD CORPORATION, GUY A. THOMPSON, as Trustee of the properties of Missouri Pacific Railroad Company, JAMES S. ALEXANDER, as Trustee, and his successors under an Agreement dated December 20, 1929, between him, The Western Pacific Railroad Corporation, The Denver and Rio Grande Western Railroad Company and Missouri Pacific Railroad Company, and THE DENVER AND RIO GRANDE WESTERN RAILROAD COMPANY,

Respondents.

On Petition for a Writ of Certiorari to the Court of Appeals of the State of New York

BRIEF FOR RESPONDENT JULIUS KLEINERT IN OPPOSITION

RICHARD D. PHILBRICK,
Attorney for Respondent
Julius Kleinert

July 18, 1951.

INDEX

	PAGE
Opinions Below	2
Jurisdiction	2
Questions Involved	2
Statement of Facts	3
1. The Reorganization Proceedings	3
2. Treatment of the Utah Fuel Stock in the Reorganization Proceedings	5
3. The Proceedings Before the Courts Below	6
Argument	8
Conclusion	13

CASES CITED

Callaway v. Benton, 336 U. S. 132	8
Central Hanover Bank & Trust Co. v. Kelby, 133 F. 2d 873	8
Commercial Wholesalers, Inc. v. Investors Commercial Corp., 172 F. 2d 800 (C. A. 9, 1949)	9
Diversey Bldg. Corp., In re, 86 F. 2d 456 (C. A. 7, 1936)	9
Insurance Group v. Denver & R. G. W. R. Co., 329 U. S. 607	4
Nine North Church Street, In re, 82 F. 2d 186 (C. A. 2, 1936)	9
Prudence Realization Corp. v. Ferris, 323 U. S. 650 (1945)	9

PAGE

R. F. C. v. Denver & R. G. W. R. Co., 328 U. S. 495 4
Rutherford Nat. Bank v. Manniello, 271 N. Y. Supp. 69 9
San Francisco Nat. Bank v. Dodge, 197 U. S. 70 (1905) 11
Union Trust Co. v. Willsea, 275 N. Y. 164 (1937) 9, 12

STATUTES CITED

Bankruptcy Act:

Section 77 (11 U. S. C. § 205) 3
Section 77(a) (11 U. S. C. § 205(a)) 8

IN THE

Supreme Court of the United States

OCTOBER TERM, 1951

No. 98

HAROLD S. BAIRD,
Petitioner,

against

GUARANTY TRUST COMPANY OF NEW YORK, as Trustee under the First Consolidated Mortgage Deed of The Rio Grande Western Railway Company, dated April 1, 1899, JULIUS KLORFEIN, THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK, as Trustee under the Refunding and Improvement Mortgage of The Denver and Rio Grande Western Railroad Company, dated February 1, 1924, CITY BANK FARMERS TRUST COMPANY, as Trustee under The Denver and Rio Grande Western Railroad Company's General Mortgage, dated February 1, 1924, WESTERN PACIFIC RAILROAD CORPORATION, GUY A. THOMPSON, as Trustee of the properties of Missouri Pacific Railroad Company, JAMES S. ALEXANDER, as Trustee, and his successors under an Agreement dated December 20, 1924, between him, The Western Pacific Railroad Corporation, The Denver and Rio Grande Western Railroad Company and Missouri Pacific Railroad Company, and THE DENVER AND RIO GRANDE WESTERN RAILROAD COMPANY,
Respondents.

On Petition for a Writ of Certiorari to the Court of Appeals of the State of New York

---

BRIEF FOR RESPONDENT JULIUS KLORFEIN IN OPPOSITION

Opinions Below

The Court of Appeals issued no opinion, and its unanimous affirmance (R. 270-271), is reported at 302 N. Y. 658, 98 N. E. 2d 474 (1951). The unanimous affirmance without opinion (R. 260-262) by the Appellate Division, First Department, is reported at 277 App. Div. 767, 97 N. Y. S. 2d 542 (1950). The interlocutory decision of the Supreme Court, Special Term, discussing the issues sought to be reviewed herein (R. 118-127), is reported in 194 Misc. 628, 86 N. Y. S. 2d 505 (1949).

Jurisdiction

The judgment of the Court of Appeals (R. 270-271) was entered on March 9, 1951. Jurisdiction of this Court is invoked under 28 U. S. C. § 1257(3).

Questions Involved

There are two principal questions presented by the petition herein:

1. Whether in a proceeding against a surety for a deficiency judgment, the creditors are entitled, as a matter of state law, to have appraised at their cash value the new securities they have received in the reorganization of the principal debtor.

2. Whether as a matter of law the First Consolidated Bonds are precluded from further recourse against the surety.

Statement of Facts

Petitioner's failure to set out the facts in sufficient detail has given an abstract turn to the issues posed in his petition. We believe that a detailed exposition of the facts is essential to demonstrate that further review by this Court is both inappropriate and unnecessary.

1. The Reorganization Proceedings

Prior to its recent reorganization under Section 77 of the Bankruptcy Act (11 U. S. C. § 205), the Denver & Rio Grande Western Railroad Company (Denver) had outstanding several classes of bonds, including First Consolidated Mortgage bonds (First Consolidated), Refunding & Improvement Mortgage bonds (R & I) and General Mortgage bonds (General). These bonds were secured by various properties of the Denver company. It is conceded that prior to the reorganization the First Consolidated also had a first lien on the entire stock of the Utah Fuel Company up to $6,000,000 (R. 38); and that the R & I bondholders had a subordinate lien thereon which was prior to that of the Generals (R. 118, 132-133). Title to the stock was vested in a trustee, subject to the foregoing liens (R. 38). In a prior reorganization, one-half of the ultimate beneficial interest was acquired by the Western Pacific Railroad Corporation and the other by the Missouri Pacific Railroad Company, and, in consequence, the Denver company relinquished whatever rights or interests it ever had in the Utah Fuel stock (R. 44, 118). Thus, the Utah Fuel stock stood in the position of accommodation collateral which constitutes a suretyship arrangement to the extent of the pledge.

The reorganization proceeding with respect to the Denver company was instituted in 1935 by a petition filed in the United States District Court for the District of Col-

orado. An amended and modified plan of reorganization was approved by the Interstate Commerce Commission (I. C. C.) in its Third Supplemental Report dated June 14, 1943, reported in 254 I. C. C. 349. The plan was subsequently approved and confirmed by the District Court and its order of confirmation was affirmed by this Court in 1946 (*R. F. C.* v. *Denver & R. G. W. R. Co.*, 328 U. S. 495). A petition for re-examination of the plan in the light of alleged change in circumstances was denied by the District Court, and its order was upheld in 1947 by this Court (*Insurance Group* v. *Denver & R. G. W. R. Co.*, 329 U. S. 607). The plan was consummated on April 15, 1947.

The effective date of the plan was fixed at January 1, 1943, and participation for the various bond issues was determined on the basis of the principal amount of bonds plus interest arrearages to that date. Outstanding publicly held First Consolidated bonds were $15,080,000, this together with interest of $330 per $1,000 of bonds to January 1, 1943, made the total claims of the First Consolidated bonds $20,056,400. For each $1,000 in bonds plus $330 in interest, each First Consolidated bondholder received new income bonds and preferred and common stocks, as follows (R. 119, 217-218):

	Face or Par Amount of New Securities
Income bonds	$266.00
Preferred stock	970.90
Common stock	93.10

The R & I bondholders received new first mortgage and income bonds, as well as preferred and common stock, having a face or par amount equal to the face amount of their bonds plus accrued interest. The General bondholders received new common stock representing 10% of the face amount of their claim (R. 119). See also tables in 328 U. S. at 503.

2. Treatment of the Utah Fuel Stock in the Reorganization Proceedings

With respect to the Utah Fuel stock, this Court noted: "The status of the stock [Utah Fuel stock] was considered by the Commission in its original report and its several supplemental reports, and its proposals with respect to the stock remained unchanged", 328 U. S. at 528. Thus in its Original Report on an earlier plan which did not become effective, the I. C. C. expressly stated that the trustee for the First Consolidated "be permitted to obtain the release of the equities of redemption in the stock, and distribute the stock among the holders of bonds" or the proceeds thereof, 233 I. C. C. at 573 (Pl. Ex. 9, p. 78). The same view was expressed in its Second Supplemental Report, 254 I. C. C. at 26 (Pl. Ex. 9, p. 136) and its Third Supplemental Report which deals with the approved and confirmed plan. In this report the Commission expressly states: "Under the plan the old [First Consolidated] bondholders would receive directly the ownership, or the proceeds, of the fuel-company stock", 254 I. C. C. at 364 (Pl. Ex. 9, p. 167). This was also the understanding of this Court, for after referring to the provision of the plan pertaining to disposal of the Utah Fuel Stock it wrote (328 U. S. at 527):

> "The Commission took the position that this and other features of the treatment of the First Consolidated bonds were justified as compensation for 'loss in earnings position and surrender of other rights' under the plan."

Both the Commission and this Court recognized that the bankruptcy court could not direct distribution of the stock. Since the Utah Fuel stock was but accommodation collateral, or in the position of a surety, enforcement of the lien could be had only in an appropriate tribunal outside the bankruptcy court; and paragraph K of the plan (quoted

328 U. S. at 527) expressly authorized the trustee for the First Consolidated "to obtain the release of the equities in the stock of the Utah Fuel Company and distribute the stock among the holders of the aforesaid bonds * * * or * * * the proceeds recovered" therefrom.

3. The Proceedings Before the Courts Below

After the new securities of the reorganized debtor had been distributed among the bondholders, the Guaranty Trust Company, as trustee for the First Consolidated bondholders, instituted the proceedings below to enforce its prior lien on the Utah Fuel stock (R. 24-63). The trustee and intervenor-plaintiff Klorfein, one of the respondents herein, urged that (1) the First Consolidated bondholders admittedly had a valid first lien on the Utah Fuel stock for an amount not to exceed $6,000,000; (2) that the securities received by the First Consolidated bondholders under the plan did not constitute payment of their debt claim in full so as to extinguish their lien on the Utah Fuel stock; (3) that the amount of the deficiency is far in excess of $6,000,000, for the collection of which they may proceed against the collateral as contemplated and authorized by the plan. The trustee for the R & I bondholders conceded the claim of the First Consolidated, asserting only a claim for any excess which might be realized (R. 73). The trustee for the General bondholders, along with the petitioner herein, denied the foregoing claims, urging that as a matter of law only the Generals were entitled to the Utah Fuel stock and that it was so adjudicated in the reorganization proceedings (R. 77-108).

On February 17, 1949, the trial court issued an interlocutory decision (R. 118-127), reported in 194 Misc. 628, 86 N. Y. S. 2d 505. The court held that by receiving the new securities of the Denever company under the plan of reorganization, the First Consolidated bondholders were not thereby deprived, as a matter of law, of their admitted

first lien on the Utah Fuel stock to the extent of $6,000,000, and ordered that the matter be referred to a referee for hearing and report (R. 121-125). The purpose of the reference was to determine the actual value in money of the new Denver securities received in the reorganization by the First Consolidated bondholders and by the junior bondholders for their respective claims, and the terms and conditions under which the Utah Fuel stock should be sold to satisfy in the order of their priority the deficiency claims of the bondholders (R. 127-136).

On September 23, 1949, the court issued its final judgment and decree (R. 137-180), affirming the referee's findings of fact and conclusions of law and overruling exceptions thereto (R. 151). Specifically, the court found that as of April 15, 1947, when the new securities were issued to the bondholders under the plan of reorganization, the total claim of the First Consolidated bondholders was $22,260,-153, of which $15,080,000 represented principal and the balance accrued interest; and that the new securities issued to the publicly-held First Consolidated bondholders had an actual value in money of $6,755,497 (R. 147-148). Similar findings were made with respect to the Refunding and Improvement bonds and the General Mortgage bonds (R. 147-149). The court concluded that for their deficiency claim, in excess of $15,000,000, the First Consolidated were entitled to be compensated from the Utah Fuel stock to the extent of $6,000,000 (R. 149-150). Any balance of the proceeds of sale of the stock over $6,000,000 was to be paid to the bondholders whose lien on the stock was subordinate to that of First Consolidated.

The Utah Fuel stock has been sold for $6,800,000. Under the judgment of the Special Term, affirmed by the courts below, this has been substantially distributed to the First Consolidated less allowances and expenses.

ARGUMENT

Petitioner's sole argument is that as a matter of law the First Consolidated had no further rights in the Utah Fuel stock because the new securities they had received in the Denver reorganization constitutes payment in full. On that issue all the courts below found against the petitioner. We submit that the petition should be denied because (1) the rights of the First Consolidated against the stock involves no federal question but only a question of state law; (2) their prior claim against the Utah Fuel stock to the extent of $6,000,000 was not discharged because the new securities of the reorganized Denver allocated and distributed to the First Consolidated did not satisfy all of the rights and claims which their admitted first lien on that stock was designed to protect.

1. Under Section 77(a)(11 U. S. C. § 205(a)), exclusive jurisdiction of the bankruptcy court extends to "the debtor and its property", and "as a corollary, over any rights that may be asserted against it," *Callaway* v. *Benton,* 336 U. S. 132, 147 (1949). The bankruptcy court has no jurisdiction to adjudicate rights or controversies in which the debtor has no interest and which do not affect the proper administration of the estate. In such situations the parties are remitted to other courts which could more appropriately deal with the issues involved. See *Callaway* v. *Benton,* 336 U. S. 132, 142-143 (1949); *Central Hanover Bank & Trust Co.,* v. *Kelby,* 133 F. 2d 873, 875 (C. A. 2, 1943).

Petitioner does not dispute these elementary principles of bankruptcy reorganization. It is likewise admitted that the Utah Fuel stock was not the property of the Denver Company. The stock was originally pledged as additional collateral for the various bond issues, and by the transfer of the equity of redemption in 1924, as this Court noted, the Denver Company had relinquished whatever rights it ever had in the Utah Fuel stock, 328 U. S. at 528. Thus, the

Utah Fuel stock became accommodation collateral, which in substance is but a suretyship arrangement to the extent of the pledge. See *Rutherford Nat. Bank* v. *Manniello,* 271 N. Y. Supp. 69, 240 App. Div. 506 (1st Dept. 1934), affirmed per curiam, 266 N. Y. 568, 195 N. E. 203 (1935).

In substance, the suit instituted in the state court below was an action for a deficiency claim against a guarantor whose liability to the creditors is, under Section 16 of the Bankruptcy Act, not affected by the discharge of the debtor in bankruptcy. *Union Trust Co.* v. *Willsea,* 275 N. Y. 164, 9 N. E. 2d 820 (1937). Jurisdiction over such a claim cannot be asserted in the bankruptcy proceeding. *In re Nine North Church Street,* 82 F. 2d 186, 188-189 (C. A. 2, 1936); *In re Diversey Bldg. Corp.,* 86 F. 2d 456, 457-458 (C. A. 7, 1936), *certiorari denied,* 300 U. S. 662 (1937); *Commercial Wholesalers, Inc.* v. *Investors Commercial Corp.,* 172 F. 2d 800, 801 (C. A. 9, 1949). Jurisdiction over the disposition of the Utah Fuel stock necessarily was vested in the state court below; and it has been expressly recognized in the bankruptcy litigation that the adjudication of all claims with respect to the Utah Fuel stock must take place outside the reorganization proceeding because the controversy involved no interest or property of the debtor, 328 U. S. at 527-531. After trial the state court held that the First Consolidated were entitled to enforce their prior lien against the stock to the extent of $6,000,000 and the appellate courts affirmed. The rights of the First Consolidated in the Utah Fuel stock were adjudicated in accordance with state law which this Court ought not review. *Prudence Realization Corp.* v. *Ferris,* 323 U. S. 650, 654-656 (1945).

Petitioner attempts to derive some support for his argument in a suggestion by this Court, *sua sponte,* that "it may be" that under the circumstances the First Consolidated have been "fully paid by the new securities given them" and that there is "a certain illogic in the position of the First Consolidated bonds in asserting any rights in the collateral at all" (328 U. S. at 531, fn. 33). This Court,

however, added that its statement "should not be taken as deciding this question". This Court expressly left the issue open for determination in an independent suit such as the one brought in the state court below, and stated that the plan "did not in any way change or affect existing rights in the collateral" (328 U. S. at 530). The plan contemplated, and the trustee for the First Consolidated conceded, that under the circumstances enforcement of the lien was to require an independent judicial proceeding. Hence, in those proceedings the General bondholders may show "that the First Consolidated bonds have been fully paid by the securities awarded them under the plan, *if such be the fact*"; and, on the other hand, the holders of the prior lien on the stock recognized the duty to account "for any surplus remaining after they have been made whole" (328 U. S. at 530-531) (italics added). Those issues have now been fully tried and the seeming "illogic" has been resolved against the petitioner. No question of federal law is involved nor, as we show below, any inconsistency in result.

2. There is no inconsistency between the treatment accorded the First Consolidated in the reorganization proceeding and their rights, sustained by the courts below, in the Utah Fuel stock under the terms of the pledge agreement. The function of a surety is to safeguard the creditor's claim against the risk of the debtor's insolvency; and this safeguard is no less essential where, as here, the First Consolidated have received, in effect, a stock interest in the reorganized debtor. In their new position as stockholders, the First Consolidated bondholders are assuming market and earnings risks, against which they are entitled to be indemnified by the surety or the accommodation collateral. Therefore, due recognition of the suretyship or pledge agreement requires that the new securities in the reorganized company be appraised in terms of their present cash value, from which it may be determined, as the court below phrased it, whether the First Consolidated

receive "*actually* * * * in money or in money's worth the full equivalent" of their claim (R. 123) (court's italics). If on the basis of such valuation, the new securities are not the full equivalent of the amount of their debt, the secured creditors, in accordance with the terms of their contract, may enforce their deficiency claim against the surety, whose liability to them, as provided in Section 16 of the Bankruptcy Act, has not been affected or released by the bankruptcy or discharge of the debtor.

It is this vital element in the pledge agreement which the petitioner herein completely ignores. For in the determination of the relative participation of senior and junior creditors, there is no pretense that the senior creditors are receiving new securities whose *cash* value is equal to the full amount of their claim. As this Court said with respect to the First Consolidated: "The Commission did not make a finding that the *cash value* of the securities awarded the senior claimants * * * *equalled the face of the claims*", 328 U. S. at 517 (italics added). Likewise, in 329 U. S. at 617, the court again noted that no determination has ever been made that the "*cash value* of the securities allocated to the senior creditors *paid them in full*" (italics added).

For the purpose of translating the new securities into their cash value the court below concluded that the prices at which buyers and sellers trade in "a sufficiently large, free and open market" was decisive, and referred that issue, among others, to the referee (R. 124). That this is entirely correct is beyond dispute. See *San Francisco Nat. Bank* v. *Dodge*, 197 U. S. 70, 79-80 (1905). In fact, this Court, in discussing the "cash value" of the securities allocated to the First Consolidated under the Plan, specifically adverted to market prices as the applicable criterion, 326 U. S. at 617. On the basis of the evidence the referee found that the cash value of the new securities was $6,755,497 (R. 148), leaving a deficiency of over $15,000,000 (R. 149), for the payment of which the First Consolidated were admittedly secured

by a prior lien against the Utah Fuel stock for the amount of $6,000,000. These and other findings of the referee were adopted by the trial court (R. 151). *No question with respect to this determination was raised on appeal to the courts below and cannot be disputed herein.* The record expressly states that the "hearings and report of the referee dealt with matters as to which no question is raised on these appeals" (R. 4).

It may be noted that if in this case there were a surety obligated and able to pay the full amount of the First Consolidated claim, the bondholders upon receiving the new securities of the reorganized debtor could surrender these securities to the surety and require him to pay their entire claim in cash. See *Union Trust Co.* v. *Willsea,* 275 N. Y. 164, 9 N. E. 2d 820 (1937). In that event the surety and not the First Consolidated, would assume the resulting risks either by retaining the new securities or by realizing their cash value on sale in the market. In this case, however, since the total claim of the First Consolidated against the debtor amounted to $15,080,000, plus accrued interest, while their maximum right against the Utah Fuel stock was $6,000,000, this procedure for shifting the risk was not available. But, following the same principle, the court below determined the actual cash value of the securities which the First Consolidated had received under the plan, and applied that amount in determining the deficiency claim of the First Consolidated against the pledged collateral within the limits of the pledge agreement. In this manner, the courts below gave due recognition to the contractual rights of the First Consolidated in the Utah Fuel stock and realistically applied the policy underlying Section 16 of the Bankruptcy Act. Insofar as the courts below valued the new securities received by the First Consolidated by their equivalent value in cash, they were merely interpreting and enforcing the contractual rights of the First Consolidated under the agreement, and that adjudication is not subject to challenge in this Court. See *Prudence Realization Corp.* v. *Ferris, supra.*

CONCLUSION

The judgment of the court below is correct and is not in conflict with the decision of this Court. The petition should be denied for lack of merit and for want of a substantial federal question.

Respectfully submitted,

BERNARD D. FISCHMAN,
Attorney for Respondent,
Julius Klorfein.

Dated, New York, N. Y., July 13, 1951.

SUBJECT INDEX.

	PAGE
Opinions Below	1
Jurisdiction	2
Question Presented	2
Introductory	2
Statement	3
Conclusion	8

TABLE OF CASES CITED:

Denver & R. G. W. R. Co., In re, (1945), C. C. A. 10th, 150 F. (2d) 28 6

Guaranty Trust Company, etc., et al. v. *The Chase National Bank, etc., et al.* (1949), 194 Misc. (N. Y.) 628, 86 N. Y. S. 2d 505; affirmed 277 App. Div. (N. Y.) 767, 97 N. Y. S. 2d 542; 302 N. Y. 658, 98 N. E. 2d 474 ..... 1, 2

Insurance Group Committee, et al. v. *Denver & R. G. W. R. Co., et al.* (1947), 329 U. S. 607 6

R. F. C., et al. v. *Denver & R. G. W. R. Co., et al.* (1946), 328 U. S. 495 ..... 6, 7

IN THE

Supreme Court of the United States

OCTOBER TERM 1951.

No. 98.

HAROLD S. BAIRD,

Petitioner,

—against—

GUARANTY TRUST COMPANY OF NEW YORK, as Trustee under the First Consolidated Mortgage Deed of The Rio Grande Western Railway Company, dated April 1, 1899, JULIUS KLORFEIN, THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK, as Trustee under the Refunding and Improvement Mortgage of The Denver and Rio Grande Western Railroad Company, dated February 1, 1924, CITY BANK FARMERS TRUST COMPANY, as Trustee under The Denver and Rio Grande Western Railroad Company's General Mortgage, dated February 1, 1924, WESTERN PACIFIC RAILROAD CORPORATION, GUY A. THOMPSON, as Trustee of the properties of Missouri Pacific Railroad Company, JAMES S. ALEXANDER, as Trustee, and his successors under an Agreement dated December 20, 1924, between him, The Western Pacific Railroad Corporation, The Denver and Rio Grande Western Railroad Company and Missouri Pacific Railroad Company, and THE DENVER AND RIO GRANDE WESTERN RAILROAD COMPANY,

Respondents.

BRIEF ON BEHALF OF RESPONDENT, CITY BANK FARMERS TRUST COMPANY, AS TRUSTEE, UNDER THE GENERAL MORTGAGE DATED FEBRUARY 1, 1924, MADE BY THE DENVER AND RIO GRANDE WESTERN RAILROAD COMPANY.

Opinions Below.

The opinion of the Supreme Court of the State of New York, New York County, is reported at 194 Misc. (N. Y.) 628 and 86 N. Y. S. 2d 505 (affirmed, without opinion, by the Appellate Division, First

Department, at 277 App. Div. (N. Y.) 767 and 97 N. Y. S. 2d 542, and by the Court of Appeals at 302 N. Y. 658, 98 N. E. 2d 474).

Jurisdiction.

The petitioner invokes the jurisdiction of this Court under 28 U. S. C., Sections 1257(3) and 2101(C).

Question Presented.

The question presented by the petition herein is whether or not a determination in the Section 77 reorganization case, hereinafter described, to the effect that senior creditors there had received "payment in full" as required by the absolute priority rule is a determination that there has been "payment in full" for all purposes.

Stated another way, the question is whether "full payment" for the purposes of the federal courts and reorganization under the federal statutes is the same thing as, or something different from, "full payment" for the purposes of the New York courts and the settlement of liens upon accommodation collateral.

The petitioner and this respondent assert that "full payment" is just that—in either case.

Introductory.

This brief is filed in partial reply to briefs filed by two other respondents herein—to guard against possible misapprehension which might be caused by statements in those briefs.

In the brief filed on behalf of the respondent, Guaranty Trust Company, there is a footnote on page 3 pointing out that this respondent, trustee of the General Mortgage, "has not joined in the petition for certiorari" and suggesting that such omission on the part of this respondent "is significant".

In the brief filed on behalf of the respondent, Klorfein, at pages 5 and 6 it is intimated that the approved plan of reorganization (herein called the "Plan") of The Denver and Rio Grande Western Railroad Company (herein called the "D. & R. G. W.), as interpreted by this Court, allotted the Utah Fuel stock, hereinafter mentioned, to the First Consolidated bonds.

Without attempting to repeat argument made by the petitioner herein, this "reply" brief will be addressed solely to those statements made by two of the other respondents.

Statement.

[Figures in parentheses refer to folios of the Record in the New York courts.]

I.

The New York action was commenced in 1947 by the trustee under the Rio Grande Western Railway Company First Consolidated Mortgage to foreclose the lien of that mortgage on 100,000 shares of Utah Fuel Company stock, pledged thereunder in 1901 (67-109). The trustee under the D. & R. G. W. Refunding and Improvement Mortgage and this re-

spondent, City Bank Farmers Trust Company, as trustee under the D. & R. G. W. General Mortgage, were named defendants, together with other parties. The Refunding and Improvement Mortgage and the General Mortgage, both dated February 1, 1924, covered identical security and constituted, respectively, second and third liens on the stock (645, 661-2, 676). There were no unmortgaged assets (675-6).

Other classes of D. & R. G. W. creditors also held liens on some or all of the D. & R. G. W. assets prior to the lien of the General Mortgage, but the terms "senior creditors", "senior bond issues", "senior mortgages", are used in this brief to mean holders of First Consolidated bonds and Refunding and Improvement bonds and the mortgages under which those two classes of bonds were issued.

This respondent served an answer (229-324). It denied that the plaintiff had any remaining interest in the Utah Fuel stock and asserted that the indebtedness secured by the two senior mortgages had been fully paid and satisfied by the issuance of securities pursuant to the Plan, which was consummated in 1947, that this was the necessary legal consequence of the Plan (which permitted the participation of the General Mortgage bondholders in the Debtor's assets although admittedly all of the Debtor's assets were subject to the prior lien of the Refunding and Improvement Mortgage), and that accordingly the Utah Fuel stock or its proceeds should be distributed to the holders of the General Mortgage Bonds to satisfy the unpaid part of the debt owed to them.

The answer of this respondent was adopted by

Baird, an owner of General Mortgage bonds and the petitioner herein.

The New York courts decided the issue adversely to the contention of the General Mortgage trustee. They held that there were deficiencies on all three bond issues, the deficiency in each case being the difference between (a) the total claim allowed in the reorganization with interest, and (b) the market value of the Plan securities provided in exchange as of the date such securities became available (439-449); plus interest on such difference (449). They further held that the First Consolidated Mortgage constituted a lien on the Utah Fuel stock to the extent of $6,000,000 and the Refunding and Improvement Mortgage and General Mortgage constituted the second and third liens, respectively, to the extent of their full deficiencies (428-430).

Pursuant to the New York final judgment and decree (409), the Utah Fuel stock was sold at public auction on April 11, 1950. The propriety of the sale is not disputed. The final judgment awarded $6,000,000 of the proceeds to the claim of the First Consolidated Mortgage trustee and the balance, or $800,000, to the claim of the Refunding and Improvement Mortgage trustee, subject to deduction of expenses. The present controversy relates to the disposition of the proceeds. This respondent the General Mortgage trustee, and its bondholder, the petitioner herein, claim that the net proceeds should be applied exclusively to the deficiency on the General Mortgage bonds.

This respondent appealed from the judgments (13-24), briefed and argued the case in the Appellate Division and later participated in the argument in the Court of Appeals.

This respondent did not apply to this Court for writ of certiorari solely because, as trustee, it now holds no funds or property (other than the rejected claim to the Utah Fuel stock) from which the expenses of such application could be defrayed.

II.

The Plan provisions relating to the Utah Fuel stock were twice considered by this Court. See *R. F. C. et al.* v. *Denver & R. G. W. R. Co., et al.* (1946), 328 U. S. 495, and *Insurance Group Committee, et al.* v. *Denver & R. G. W. R. Co., et al.* (1947), 329 U. S. 607. The Plan contained language which might seem to mean that the First Consolidated bondholders would thereunder receive directly the ownership, or the proceeds, of the Utah Fuel stock. In the reorganization proceedings this respondent argued that there had been no determination of the value of the Utah Fuel stock, that the I. C. C. obviously had treated the stock as having negligible value and had awarded it to the First Consolidated bondholders without due determination of its value. The Debtor, on the other hand, had asserted that the stock had a value in the neighborhood of $20,000,000. This respondent also pointed out that the senior bondholders had been allowed to prove against the D. & R. G. W. for the full respective amounts of their claims, without making any allowance for the value of the pledged Utah Fuel stock.

It was the unanimous view of the Circuit Court of Appeals for the Tenth Circuit that this respondent's objections to the Plan based upon the Utah Fuel features were well taken. See *In re Denver & R. G. W. R. Co.* (1945), 150 F. (2d) 28, at pages 39-40;

also see 328 U. S. at page 528. That Court held that the holders of the First Consolidated bonds should be compelled either to foreclose on their collateral, applying the proceeds to their claim, or should credit their claim with the value of the collateral and be allowed new securities only for the balance. The Circuit Court further pointed out that the Commission had permitted doubts and uncertainties to remain with respect to the value of the collateral and that, if the collateral had substantial value, the First Consolidated bondholders might receive more than full payment.

To meet the contention of this respondent and the views expressed by the Circuit Court of Appeals, the senior creditors argued in this Court in the reorganization case that the Utah Fuel stock, being "accommodation collateral", could not be disposed of by the Plan—notwithstanding the Plan language which seemed to award the stock to the First Consolidated bondholders. This Court in the reorganization case adopted that argument of the senior creditors and held that the senior creditors were "entitled to be paid in full in new securities without regard to the collateral" and that, since the senior creditors "are entitled only to full payment", it would then seem to follow that the senior creditors "have no rights against the collateral [the Utah Fuel stock]". See 328 U. S. 531, Note 33.

However, upon the institution of the proceedings in the New York courts for the foreclosure of the First Consolidated Mortgage lien upon the pledged collateral, the trustee of that mortgage and the respondent, Klorfein, a holder of bonds secured by that mortgage, once more asserted that by the Plan the Utah Fuel stock was awarded to the First Con-

solidated bondholders. The brief now filed in this Court on behalf of the respondent, Klorfein, repeats that contention—although the contention is directly contrary to the position previously taken in this Court by the senior creditors when the Plan was being considered by this Court and also is contrary to the holding of this Court in that reorganization case where this Court adopted the views at that time urged by the senior creditors.

Conclusion.

For the reasons set forth in the Statement, it is respectfully submitted that the failure of this respondent to join in the petition for certiorari is not "significant" and does not indicate any change of position on the part of the General Mortgage trustee. To the extent appropriate, the respondent, City Bank Farmers Trust Company, as trustee under the General Mortgage, hereby joins in the application of the petitioner for writ of certiorari and urges that it be granted.

Respectfully submitted,

JOHN B. MARSH,
EDWARD E. WATTS, JR.,
Attorneys for Respondent City Bank Farmers Trust Company, as Trustee.

MITCHELL, CAPRON, MARSH,
ANGULO & COONEY,
Of Counsel.

July 19, 1951.

FILED
JUL 27 1951
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM 1951

No. 98

HAROLD S. BAIRD,
Petitioner,

against

GUARANTY TRUST COMPANY OF NEW YORK, etc., et al.,
Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF NEW YORK

REPLY BRIEF FOR PETITIONER IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

JULIUS LEVY,
Attorney for Petitioner,
295 Madison Avenue,
New York 17, N. Y.

INDEX

PAGE

I. Guaranty's distribution of $6,000,000 did not render the case moot since:

(a) There is still an undistributed fund of $800,000; and

(b) Petitioner has a right to the restitution of the $6,000,000 1

II. The federal question herein arises from the disregard by the New York court of the adjudication of full payment made by the federal courts pursuant to a federal statute 3

III. The bankruptcy courts adjudicated that the new Denver securities awarded to the Consolidateds and the Refundings paid them in full 4

IV. Under the absolute priority rule, an adjudication of full payment in new securities is the equivalent of an adjudication of full payment in cash 6

Appendix 9

CASES CITED

Arkadelphia M. Co. v. St. Louis S. W. R. Co., 249 U. S. 134 (1919) 2

Ecker v. Western Pac. R. Corp., 318 U. S. 448 (1943) 7

Haebler v. Myers, 132 N. Y. 363, 30 N. E. 963 (1892) 2

Heiser v. Woodruff, 327 U. S. 726 (1946) 3

Insurance Group Committee v. Denver etc. Co., 329 U. S. 607 (1947) 5, 6

Langley v. Warner, 3 N. Y. Super. 209 (1848) 2

Morris, Ex parte, 9 Wall. (76 U. S.) 605 (1870) 2

PAGE

Nine North Church Street, Inc., In re, 82 F. 2d 186 (C. C. A. 2, 1936) 7

Penhallow v. Doane's Admrs., 3 Dall. (3 U. S.) 54 (1795) 2

Prudence R. Corp. v. Ferris, 323 U. S. 650 (1945) 3

R.F.C. v. Denver etc. Co., 328 U. S. 495 (1946) 4, 5, 6, 7

S.E.C. v. Central-Illinois S. Corp., 338 U. S. 96 (1949) 7

Stoll v. Gottlieb, 305 U. S. 165 (1938) 3

STATUTE CITED

Bankruptcy Act, § 77(e) 3

IN THE

Supreme Court of the United States

OCTOBER TERM 1951

No. 98

HAROLD S. BAIRD,

Petitioner,

against

GUARANTY TRUST COMPANY OF NEW YORK, etc., et al.,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF NEW YORK

REPLY BRIEF FOR PETITIONER IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

(The briefs for respondents Guaranty, Chase and Klorfein are herein referred to as "G.", "C." and "K.")

I. Guaranty's distribution of $6,000,000 did not render the case moot since:

(a) There is still an undistributed fund of $800,000; and

(b) Petitioner has a right to the restitution of the $6,000,000.

Guaranty Trust Company ("Guaranty" hereinafter) contends that, by distributing to the Consolidated bondholders

most of the $6,000,000 which it collected under the judgment below, it has rendered the controversy moot (G. 5). There are two simple answers.

1. Utah Fuel was sold for $6,800,000. The $800,000 which, under the judgment below, is to go to the Refundings has admittedly not been distributed by respondent Chase. Admittedly, therefore, the controversy relating to this $800,000 is not moot.

2. Nor is it moot concerning the $6,000,000 which Guaranty allegedly distributed to the Consolidated bondholders. For if this Court should reverse the judgment below, Guaranty must repay the $6,000,000 to the Generals by way of restitution; *Arkadelphia M. Co.* v. *St. Louis S. W. R. Co.*, 249 U. S. 134, 145 (1919); *Haebler* v. *Myers*, 132 N. Y. 363, 30 N. E. 963 (1892). Guaranty could not defeat this duty by distributing the moneys any more than by spending or wasting them; *Penhallow* v. *Doane's Admrs.*, 3 Dall. (3 U. S.) 54, 87 (1795); *Langley* v. *Warner*, 3 N. Y. Super. 209, 213 (1848).

Guaranty says that an order of the state court compelled it to make the distribution. The fact is that Guaranty itself procured the order (see Appendix); and, in any event, the significance of the order does not appear, since Guaranty does not argue that the order relieves it from the duty to make restitution. Indeed, the distribution order merely carried out a provision of the state court's judgment (R. 163); and once that judgment is reversed, the order, based on the judgment, falls with it.*

Finally, if the judgment below is reversed, the Generals will have a right of restitution not only against Guaranty, but also against those Consolidated bondholders to whom the $6,000,000 was distributed; *Ex parte Morris*, 9 Wall. (76 U. S.) 605 (1870). Those bondholders are represented herein by Guaranty as their indenture trustee; they will therefore be bound by the decision of this Court deter-

* Guaranty suggests in its brief (G. 5, 14) that it was lulled by petitioner's inaction into proceeding with the distribution. The factual answer will be found in the Appendix of this brief.

mining which group of bondholders is entitled to the $6,000,000. Thus, far from presenting a controversy which is wanting in "present actuality," as Guaranty would have the Court believe (G. 6), the case at bar will directly determine the rights of the parties to a large sum of money.

II. The federal question herein arises from the disregard by the New York court of the adjudication of full payment made by the federal courts pursuant to a federal statute.

Respondents contend that no federal question is involved because the pledge of the Utah Fuel stock was governed by New York law (G. 7; C. 6; K. 9). But the validity and effect of the pledge under New York law are not in dispute. The issue here is whether the two senior pledgees—the Consolidateds and the Refundings—have been paid in full in the Denver reorganization. We say it was so adjudicated by this Court and the other bankruptcy courts; the adjudication was based upon the satisfaction of the seniors' right to full payment under the absolute priority rule; and that rule, in turn, rests on the requirement of "fair and equitable" treatment under § 77(e) of the Bankruptcy Act. The effect of the bankruptcy courts' finding of full payment is thus clearly a question of federal law; and the decisions of this Court so hold:

> "When they [the parties] came into a New York court seeking a determination of their present rights, that court was obliged to ascertain whether any rights had been fixed by the reorganization plan and, if so, to enforce them."
>
> *Prudence R. Corp.* v. *Ferris*, 323 U. S. 650, 656 (1945).
>
> "As the contention is that the ruling below disregarded decrees of a court of the United States, it raised a federal question reviewable under § 237(b) of the Judicial Code, 28 U. S. C. A. § 344(b)."
>
> *Stoll* v. *Gottlieb*, 305 U. S. 165, 167, 171 (1938).

See: *Heiser* v. *Woodruff*, 327 U. S. 726, 733 (1946).

III. The bankruptcy courts adjudicated that the new Denver securities awarded to the Consolidateds and the Refundings paid them in full.

1. This adjudication has been demonstrated in our petition (pp. 5-7). Respondents nevertheless deny it (G. 10-11; C. 3-4; K. 10). They invoke the statement of this Court that, in the judicial proceedings for the enforcement of the Utah Fuel liens, the Generals may show that the Consolidateds have been fully paid, "if such be the fact" (*First Denver case*, 328 U. S. 495, 530).

However, that phrase is immediately followed, in this Court's opinion, by a footnote (328 U. S., at 531, fn. 33) to the effect that the Consolidateds may well be precluded, as a matter of law, from any claim to Utah Fuel by their failure to take an appeal from the District Court's decision confirming the reorganization plan as fair and equitable. This Court thus carefully refrained from holding that the question of full payment to the seniors is one of fact. On the contrary, it indicated that *res judicata* might play an important part in the litigation over Utah Fuel. Of course, this Court had no jurisdiction in the Denver reorganization to determine which parties were ultimately entitled to Utah Fuel. Accordingly, it left that question, including the *res judicata* effect of the finding of full payment, for decision in the present action.

2. The Consolidateds advance two further arguments (neither of which applies to, or is invoked by, the Refundings).

(a) In the first place, the Consolidateds say that their mortgage covered only part of the Denver properties and hence was "not a senior mortgage within the meaning of the full priority rule", so that the priority rule was not

applicable to them (G. 3).* However, in the Denver reorganization the Consolidateds did claim emphatically that they were entitled to all the benefits of the absolute priority rule (Ex. E, p. 69; see our petition, p. 5). This Court sustained the Consolidateds' claim to full payment and held that it was satisfied by the award of new securities.** This adjudication of full payment cannot now be impugned on the theory that this Court erred in allowing the Consolidateds' claim to full payment.

(b) Secondly, the Consolidateds invoke certain language of the Denver's reorganization plan and the reports of the I.C.C. as evidencing the Commission's intention that the Consolidateds were to have the Utah Fuel stock (G. 9-10; K. 5-6).† But this very contention was advanced in the *First Denver case* and was rejected by this Court: "We do not so read the plan" (328 U. S., at 529).

The Consolidateds' argument seems to imply that, under the Denver plan, both the new securities and the Utah Fuel stock were considered necessary to make the Consolidateds whole. But this Court expressly rejected such an interpretation. In discussing the accommodation collateral (i.e., the Utah Fuel stock), it held that the Consolidateds "were properly permitted to prove the full amount of their debt" and "need not deduct the value of that collateral or its proceeds in proving [their] debt" (328 U. S., at 529). This Court then repeated that the Consolidateds were "entitled to be paid in full in new securities *without regard to*

---

* The Refundings do not dispute that their mortgage was wholly senior to the General Mortgage.

** "* * * they [the Consolidateds] concede and we now hold [that] they are entitled to be paid in full in new securities" (328 U. S., at 531, fn. 33).

"* * * the priority rule was satisfied by this type of allocation [of new securities]" (329 U. S., at 617).

† There exists no comparable language in favor of the Refundings.

the collateral" (328 U. S., at 531, fn. 33, emphasis added). Since all these requirements were "held satisfied" (329 U. S., at 617), we submit that the adjudication of full payment to the Consolidateds as well as the Refundings is clear beyond dispute.

IV. Under the absolute priority rule, an adjudication of full payment in new securities is the equivalent of an adjudication of full payment in cash.

1. Respondents say that this Court—in requiring "full payment" to senior claimants under the priority rule—used the word payment "in a special sense—not in the sense in which the word is generally understood" (C. 6).

If that were true, this Court would have gone to great lengths in obscuring the meaning of the priority rule. We refuse to believe that it did. When this Court held again and again that, under the priority rule, seniors must be "paid in full" or "satisfied in full" or "made whole", we believe it meant exactly what it said.

Indeed, what else could it have meant? Respondents give this answer: "Full payment" under the priority rule means merely that the new securities given to a senior creditor must "afford him substantially as favorable an opportunity for ultimate payment as did his old securities" (C. 6). In other words: If a senior creditor with a $1,000 claim has, because of the debtor's doubtful solvency, only a 20% chance of being paid, then the priority rule is satisfied if he gets new securities which likewise have only a 20% chance of being paid and are therefore worth only $200; once this is done, junior creditors and even stockholders may participate in the reorganization.

This version of the priority rule, and its characterization by the New York court as a mere legal fiction, would, of course, destroy the "full and absolute" nature of the rule. Such an attempt to dilute the priority rule is refuted by this Court's holding that "senior claims first receive secu-

rities *of a worth sufficient to cover their face and interest* before junior claims receive anything"; *Ecker* v. *Western Pac. R. Corp.*, 318 U. S. 448, 483 (1943, emphasis added); *First Denver case*, 328 U. S. 495, 517 (1946). Obviously, if a senior creditor is to be paid in cash, he must receive 100 cents on the dollar before the juniors' turn arrives. He cannot fare worse if he is paid in new securities; for "the standard of compensation to be accorded security holders does not depend upon whether their security interests are to be retired by exchanging them for new securities in a continuing enterprise or by payment in cash"; *S. E. C.* v. *Central-Illinois S. Corp.*, 338 U. S. 96, 143 (1949).

It follows, we submit, that an adjudication of full payment in new securities under the absolute priority rule is no less effective than an adjudication of full payment in cash to bar further claims of the creditor against a surety or against accomodation collateral.

2. Respondents' position should not commend itself to considerations of broad equity. If respondents had sold the Utah Fuel stock during the pendency of the Denver reorganization—as they were free to do *—they would have received the full cash proceeds of the collateral. But then their claims in the Denver reorganization would have been reduced *pro tanto;* they would have received a smaller amount of new securities; and a correspondingly larger amount of new securities would have become available for the Generals. Respondents elected not to take this course. Instead they proved—again quite properly (328 U. S., at 529)—the full amounts of their claims in the Denver reorganization, without any deduction for the collateral, and demanded full payment of these claims in new securities. This they received, and the junior Generals were relegated to 10% of their claim in the form of new stock.

---

* *First Denver case*, 328 U. S., at 529-530; *In re Nine North Church Street, Inc.*, 82 F. 2d 186 (C. C. A. 2, 1936).

The fact that respondents received their full payment in the form of new securities resulted thus from their own deliberate choice to let the cash obtainable from Utah Fuel go and, instead, to get full payment in new securities, with their inherent possibility of appreciation. Respondents cannot have their cake and eat it; having demanded and received full payment in reorganization securities, at the expense of the Generals, they cannot, again at the Generals' expense, seek further payment out of the accommodation collateral.

Respondents, we submit, are precluded by the bankruptcy courts' adjudication of full payment under the priority rule; and since the state courts refused to recognize this adjudication, we submit that a writ of certiorari should be granted.

Respectfully submitted,

JULIUS LEVY,
Attorney for Petitioner.

Dated: New York, N. Y., July 26, 1951.

APPENDIX

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM 1951

No. 98

HAROLD S. BAIRD,

Petitioner,

against

GUARANTY TRUST COMPANY OF NEW YORK, etc., et al.,

Respondents.

Affidavit of Julius Levy

STATE OF NEW YORK }
COUNTY OF NEW YORK } ss.:

JULIUS LEVY, being duly sworn, deposes and says:

I am the attorney for the petitioner and a member of the firm of Pomerantz Levy Schreiber & Haudek, who were the attorneys for petitioner in the courts below. This affidavit is in reply to that of Mr. Theodore Kiendl, which is annexed to the brief for respondent Guaranty Trust Company.

Mr. Kiendl's affidavit and the brief for respondent Guaranty Trust Company suggest that petitioner "stood idly by" while Guaranty, "under the compulsion of" the distribution order, distributed the sum of $6,000,000 to the Consolidated bondholders. The facts are:

The judgment of the New York Supreme Court was affirmed by the Appellate Division on May 23, 1950. On June 2, 1950 we moved the Appellate Division for reargument or leave to appeal. When this motion was denied on June 21, 1950, we addressed, on July 12, 1950, a motion for leave to appeal to the Court of Appeals, which motion was granted on October 5, 1950. While these proceedings were in progress, Guaranty moved for an order authorizing and directing it to distribute the $6,000,000 to the Consolidated bondholders. We strenuously opposed the motion; but it was granted on September 14, 1950. On the very next day, September 15, Guaranty published in the New York Times an advertisement inviting the Consolidated bondholders to tender their bonds for payment of their share of the $6,000,000. The same day, September 15, 1950, we served our notice of appeal from the distribution order. We did not ask for a stay of the order because the court stated that the supersedeas bond would be in the prohibitive amount of $200,000 (i.e., 3% of $6,800,000; Judge Pecora's decision of August 9, 1950, New York Law Journal, p. 215, cols. 5-6).

Guaranty thus procured the distribution order and proceeded with the distribution with full knowledge that our appeal was pending in the New York Court of Appeals; that this appeal was being pressed by us energetically; and that we had exhausted all available avenues to postpone the distribution.

We did not thereafter press our appeal from the distribution order for a number of reasons. In the first place, distribution was proceeding apace, so that the decision of the appeal would have been too late to prevent distribution. Secondly, it appeared wiser to postpone the prosecution of the appeal from the distribution order until there was a final decision on the main appeal on the merits; for if we should ultimately fail on the merits, the appeal from the distribution order would become academic. Finally, we concluded that the distribution order did not relieve Guar-

anty and the Consolidated bondholders from the duty to make restitution if the judgment itself was reversed; and since Guaranty's financial responsibility is not in doubt, a reversal of the distribution order would have had small practical value. The proceedings up to this point—our pending appeal on the merits, our objections to the distribution order and our appeal therefrom—were sufficient in our opinion to put Guaranty on notice that we did not acquiesce in its conduct.

Ultimately Guaranty moved to dismiss our appeal from the distribution order "for want of prosecution" (not, as Mr. Kiendl implies, as moot); and this motion was granted, over our objection, by the Appellate Division on May 22, 1951.

JULIUS LEVY.

Sworn to before me this
26th day of July, 1951.

ETHEL RADIN
Notary Public, State of New York
No. 24-8479000
Qualified in Kings County
Certs. filed in N. Y. Clk. & Reg. Offices
and Kings Co. Reg. Office
Commission expires March 30, 1952